



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TEGE EXAMINATIONS  
Attn: Mandatory Review, MC 4920 DAL  
1100 Commerce St.  
Dallas, TX 75242

501.06-00

**Date:** September 1, 2010

Number: **201050040**  
Release Date: 12/17/2010

LEGEND

ORG = Organization name      XX = Date      Address = address

ORG  
ADDRESS

**Employer Identification Number:**  
**Person to Contact/ID Number:**  
**Contact Numbers:**  
Voice:  
Fax:

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear :

In a determination letter issued in July 19XX, you were held to be exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(6) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(6) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On March , 20 , you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(6) of the Code.

You have filed taxable returns on Form[s] 1120, *US Corporation Income Tax Return*, for the year[s] ended December 31, 20XX, and 20XX. For future periods, you are required

to file Form 1120 with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally

correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

Enclosures:  
Form 6018-A



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service

March 9, 2010

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail – Return Receipt Requested

Dear

We are enclosing a copy of our report of examination explaining proposed adjustments to the amount of your tax for the year(s) shown above. The report identifies the act, or failure to act, on which these adjustments are based and which requires correction.

If you accept our findings, please write or call the contact person at the telephone number or address shown in the heading of this letter.

If you do not accept our findings, you may appeal the proposed adjustments through our Appeals Office. Publication 3498 and Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference with Appeals, you must submit a written protest within 30 days from the date of this letter. An Appeals officer will review your case. The Appeals Office is independent of the Director, EO Examinations. Most disputes considered by Appeals are resolved informally and promptly.

You may also request that we seek technical advice as explained in Publication 892. If a technical advice decision is reached, with which you do not agree, you may then appeal that decision to the Appeals Office, as explained above.

If we do not hear from you within 30 days from the date of this letter, we will issue a Statutory Notice of Deficiency based on the adjustments shown in the report of examination. We will also notify appropriate state officials of the adjustment in accordance with section 6104(c) of the Internal Revenue Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette Downing  
Director, EO Examinations

Enclosures:  
Publication 594  
Publication 892  
Publication 3498  
Report of Examination  
Copy of this Letter

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended <b>20XX12</b>

**LEGEND**

ORG = Organization name      XX = Date      State = state      County = county  
City = city      CO-1, CO-2 & CO-3 = 1<sup>st</sup>, 2<sup>nd</sup> & 3<sup>rd</sup> COMPANIES

**ISSUES**

Whether this exempt organization's (EO) activities permit it to continue to be exempt under §501(c)(6).

In the alternative, if the organization's exempt status under section 501(c)(6) is upheld, should the nonexempt activities' income be taxable as unrelated business income under section 511 of the Code?

**FACTS**

ORG (ORG), was granted exemption under §501(c)(6) on 07/22/19XX. The EO's exempt purpose as stated in Certificate of Incorporation is "for which the corporation is formed are to encourage and support the industries of the State, afford a medium of cooperation among the industries, work for constructive policies, oppose class legislation, to initiate, encourage, foster, and promote constructive activities on behalf of industry. ORG supports any industry, organization or business (public or private-service or manufacturing) with one or more employees."

The 20XX Form 990 states that the organization's primary purpose is to "support industries in Central State".

The EO's brochure states "ORG's territory covers two-thirds of the geographical area within the state of State with a concentration of members in City, County, County, County, County, City, City, City, City, City and City. It represents approximately businesses from all sectors of the economy in central State."

The brochure also states "Membership in (which is by invitation) is comprised of both large and small manufacturers, educational institutions, banks, hospitals, insurance companies and utilities located throughout ."

From the EO's brochure on their website:

**Our Purpose**

ORG is an employer association providing members in with information, training and practical business solutions.

**Vision**

To be a primary resource for business, employer and human resource needs.

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### **Mission**

ORG's primary mission is to provide high quality information, advice, training and services to employers in the areas of human resource management and operational effectiveness. ORG will remain responsive and adaptive to its members' needs.

Based upon a written response to an Information Document Request, the EO's program service activities consist of the following:

**Human Resources** - training, consultation, forms and procedures on wide variety of HR topics.

1. Service provider: CO-1
2. Service description: Help with understanding and compliance with labor & employment law practices, state & federal regulations and human resources best practices.
3. Frequency of service: Ongoing
4. Time spent/resources utilized: 50-75% of time goes to this. Email, telephone and website resources are utilized. Biggest resource is utilization of my time.
5. How provided: Through website, newsletter, email, seminars and meetings
6. Purpose served: Education of members and assistance to them in developing

**Assessments** – pre-employment testing, anti-discrimination, employee developmental

1. Service provider: Profiles International provides pre-employment testing,
2. Service description: Employment screening, compliance and employee development tools
3. Frequency of service: Ongoing availability, minimal utilization of assessments
4. Time spent/resources utilized: Minimal time spent/ minimal demand on resources
5. How provided: services provided via ORG's website,
6. Purpose served: Provide members with a validated and anti-discriminatory means of screening candidates for employment and job selection.

**Insurance** – Health Insurance and Long Term Care Insurance Benefits

1. Service provider: CO-2s (Health Insurance) & CO-3 (Long Term Care)
2. Service description: CO-2's small group health plan is offered to members with 1-99 employees. Members who enroll get free vision care and free Employee Assistance Plan benefits. CO-3's Long Term Care insurance product is offered to ORG members at a discounted rate.
3. Frequency of service: These services are offered on an ongoing basis to ORG members.
4. Time spent/resources utilized: Most of ORG's efforts involve awareness and promotion through the newsletter, emails and website.
5. How provided: Services are provided by a third party.
6. Purpose served: *(None Provided)*

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**Seminars** – such as Software Training and seminars on HR and managerial topics

1. Service provider: ORG, Central State Community College and an occasional outside instructor.
2. Service description: Training is offered on in Microsoft Office Suite (Word, Excel, PowerPoint and Access – Versions 20XX and
3. Frequency of service: 20XX). Training is also offered on a variety of topics relating to management & supervisory skills, labor & employment law and state & federal regulation compliance issues.
4. Time spent/resources utilized: There are approximately 20 seminars per year. Half are human Resources related, the other half related to software training.
5. How provided: Most of the Human Resources seminars are provided at ORG's Office conference room. All of the software training classes are conducted in the Central State Community College's Computer Lab.
6. Purpose served: The training fulfills a need employers have to develop their employees or to upgrade their skills which they are unable to deliver themselves.

**Background Checks** – Involving Criminal Records, In-Depth Employment Verification, Driving Records, Education Verification, Social Security, Personal and Professional References.

1. Service provider: Capital Association Industries, City, State
2. Service description: Reference and Background Service offers a number of service options, allowing companies to select only those reports necessary to meet their specific job-related needs. Options: Criminal records, Basic and in depth employment verification, Driving records, Education verification, Social Security, Personal and professional references
3. Frequency of service: Ongoing
4. Time spent/resources utilized: ORG promotes the service through it's' newsletter, emails and website.
5. How provided: Services are provided to members online through a third party in City, State.
6. Purpose served: Companies conduct background checks to protect themselves against Negligent Hiring, False Skill or Training Claims, Workplace Violence, Employee Theft and Fraud and Lawsuits & False Claims. ORG offers these services to members at much less cost than national providers.

**Annual Wage & Benefits Survey** – A free service provided to all members who participate in the Survey. The Survey is available for purchase to non-participating members and nonmembers for a fee.

1. Service provider:
2. Service description: The survey provides job classification data, information on benchmark jobs, serve as the basis for establishing pay ranges and provide a framework for establishing minimum salaries. It also provides information on key employer provided benefits.

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3. Frequency of service: Annually
4. Time spent/resources utilized: Considerable time is spent devising the survey questionnaire determining it's' scope, content and format. From survey questionnaire to publishing the final results might entail several weeks of time.
5. How provided: The questionnaire and survey result are provided via email in MS Word or PDF format. Currently exploring the capability of offering the questionnaire online.
6. Purpose served: Enables participating companies to be aware of the marketplace salaries and benefits being offered by others as they compare with their own.

**Employment Services** – We offer free listing of their job openings on our website. We also allow candidates to post a brief resume to our website.

1. Service provider:
2. Service description: This service is not a mainstream activity of the organization. It is more of a courtesy service to applicants seeking positions and to employers seeking qualified applicants. Occasionally, we are asked to help an employer with their search. When we find a qualified candidate we will request a small fee of usually 5% of base salary.
3. Frequency of service: This is extremely rare. It has occurred only once in the nine years I have been here.
4. Time spent/resources utilized: Time spent is associated with receiving and posting resumes and job opening member companies want us to list on our website. This service does not place a big demand on our time or resources.
5. How provided: Service is provided via emails and our website.
6. Purpose served: This service is more of a courtesy to members and those seeking employment with them. It is possible that this service could be further developed, but with current staffing it would not necessarily be managed as it should to be successful.

Information from the EO's 20XX Form 990:

On page 1, Part 1, line 12, the EO's Total revenue is \$.

On page 1, Part 1, line 2, Program service revenue is \$. Included in program service revenue are the following:

Seminar Income	\$ \$
Consulting Income	\$ \$
Training Services	\$ \$

On page 1, Part 1, line 3, Membership dues are \$ \$.



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On page 1, Part 1, line 4, Interest on savings and temporary cash investments is \$.

On page 1, Part 1, line 9c, Net income from fundraising activities (sponsoring a golf tournament) is \$\$.

On page 8, Part VII, the exclusion code of "3" was used to exclude program service revenue from unrelated business income

### **LAW**

In Section 501(c)(6) of the Code, it defines business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

In Section 1.501(c)(6)-1 of the regulations, it provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self sustaining, is not a business league.

Section 1.513-1(b) of the regulations provides that the term "trade or business" for purposes of section 513 of the Code has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or services.

In section 1.513-1.(d)(2) of the regulations, in defining unrelated trade or business provides that where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business.

In Section 1.162-20(c)(4) of the regulations, it says attempting to influence legislation germane to the common business interests of an organization's members constitutes grass-roots lobbying, for which no business deduction (for example, the allocable portion of members' dues) is allowed.

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In Rev. Rul. 56-65, it states that a local organization whose principle activity consists of furnishing particular information and specialized individual services to its individual members through publications and other means is performing particular services for individual persons. Such an EO is therefore not entitled to exemption under §501(c)(6).

In Rev. Rul. 59-391, it states tax exemption has been denied for lack of a sufficient common business interest involving an organization of individuals engaged in different trades or professions not in competition who exchanged business information.

In Rev. Rul. 61-177, it follows, therefore, that its legislative activities are germane to the attainment of its objectives. Accordingly, it is held that it qualifies for exemption from Federal income tax as a business league within the contemplation of section 501(c)(6) of the Code even though its sole activity is the advocacy of legislation.

In Rev. Rul. 67-182 it states that a business league was denied exemption for maintaining a library for its members' use.

Rev. Rul. 68-264 defines a particular service for the purposes of section 501(c)(6) of the Code as an activity that serves as a convenience or economy to the members of the organization in the operation of their own businesses.

In Rev. Rul. 68-265, it states that a tax-exempt business league will lose its exemption because it performs particular services for individual members only where the services are a principal or sole undertaking of the organization.

Rev Rul. 73-411 states, Trade associations or business leagues under section 501(c)(6) are similar to chambers of commerce, except that they serve only the common business interests of the members of a single line of business or of the members of closely related lines of business within a single industry.

In Rev Rul. 74-81, it states that by providing group workmen's compensation insurance for its members, the organization relieves the members of obtaining this insurance on an individual basis, resulting in a convenience in the conduct of their businesses. Therefore, the organization is rendering particular services for individual persons as distinguished from the improvement of business conditions in the contracting and related industries generally.

Rev. Rul. 81-175 defines the term "particular services" for the purposes of section 501(c)(6) of the Code, as acting in a manner which provides an economy or a convenience for members in the operation of their own businesses.

In Produce Exchange Stock Clearing Association v. Helvering, 71 F.2d 142, 144 (2d Cir. 1934) it was ruled that an organization was held not to be entitled to tax exemption

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as a business league because nothing is done to advance the interests of the community or to improve the standards or conditions of a particular trade.

In Retailers Credit Ass'n of Alameda County v. Commissioner of Internal Revenue 90 F.2d 47, C.A.9 1937. May 10, 1937, Exemption from petitioner from taxation must be denied on the ground that the purpose to engage in a business of a kind ordinarily carried on for profit is not incidental to a main or principal purpose, but is in fact a principal or main purpose.

In MIB, Inc. v. Commissioner of Internal Revenue, 734 F.2d 71 (1st Cir. 1984), The court noted that a business league must not only improve the conditions of a line of business, but must do so in a way different from simply supplying products or services to its members. The problem with the services in MIB, however, was that the "information exchange is developed around responding to individual member requests for data relevant to applicants seeking to buy insurance from that member." *Id.* While business leagues "chiefly perform services for members collectively, MIB performs specific services for individual members."

In Southern Hardwood Traffic Ass'n v. U.S. 283 F.Supp. 1013 D.C.Tenn. 1968. March 13, 1968, the District Court, Bailey Brown, Chief Judge, held that unincorporated association engaged in regular business of providing, as one of its two main purposes and as substantial part of its total activity, majority of its members with individual services of kind ordinarily carried on for profit was not a 'business league' entitled to tax exempt status.

In American Plywood Association v. United States, 267 F. Supp. 830 (W.D. Wash. 1967) determined that the "line of business" rule generally requires that a trade group represent an entire industry.

In King County Insurance Association v. Commissioner, 37 B.T.A. 288 (1938) held that an association of insurance agents collecting (as an insubstantial activity) commissions on municipal insurance placed through its members is a business activity.

In Louisiana Credit Union League v. U.S. 693 F.2d 525 held insurance endorsement and administration is not the sort of unique activity that satisfies the substantial relationship test, nor is its benefits inherently group-related. Rather than merely advising its members of the availability and desirability of insurance coverage to credit unions generally, LCUL promoted the purchase of policies from a particular carrier, CUNA/CUMIS. The district courts observed that LCUL's insurance activities did little more than generate revenue for the League and provide CUNA/CUMIS with convenient services in the marketing and administration of its programs. Because the League's insurance endorsement is basically a fundraising activity, it is by definition unrelated business activity under section 513(a). We therefore affirm the holding below that

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LCUL's trade or business of insurance endorsement and promotion was not substantially related to its exempt function.

In Professional Insurance Agents of Michigan v. Commissioner, 726 F.2d 1097 (6<sup>th</sup> Cir. 1984) it was held that an activity of a business league was a tax-exempt function where the activity benefited is membership as a group, rather than in their individual capacities. The benefit to the group occurred where a business league provided a product or service to its members for a fee, with the benefit not directly proportional to the fees (for example, seminars, and legislative activities). This court wrote that services which render benefits according to the fee that is paid for them are taxable business activities, not tax-exempt services.

In American Association of Engineers Employment, Inc. v. Commissioner, 11 T.C.M. 207 (1952), aff'd 204 F.2d. 19 (7<sup>th</sup> Cir. 1953) it was ruled that operating an employment agency precludes exemption under §501(c)(6).

In Associated Master Barbers and Beauticians of America, Inc., 69 T.C. 53 (1977), the court held that an organization did not qualify as a tax-exempt business league because it both engaged in a regular business of a kind ordinarily carried on for profit and its activities were directed to the performance of particular services for individual members.

In Crooks v. Kansas City Hay Dealers' Ass'n (C.C.A.8) 37 F.(2d) 83, 85., A chamber of commerce is defined as 'a society of a city, who meet to promote the general trade and commerce of the place.'

In Carolinas Farm & Power Equipment Dealers Ass'n, Inc. v. U.S. 699 F.2d 167, C.A.N.C., 1983. January 24, 1983, we must conclude that the Association's insurance service primarily advances the interests of participating members, and so it is not related to its charitable purpose.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number of exempt purposes. Better Bus. Bureau v. United States, 326 U. S. 279. 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v. Commissioner, 92 T.C. 1056, 1065 (1989).

### **TAXPAYER'S POSITION**

Based upon a written response to an Information Document Request the organization's position is as follows:

The organization believes that it is entitled to exemption under section 501(c)(6) because its primary purpose is to serve the members by supporting their needs for: training and development, wage and salary information, human resources policies and

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procedures, labor and employment information and best practices assisting members in becoming and remaining more productive and, thus, more competitive.

The organization states that to % of the time of the CEO, the sole employee of the organization, is spent rendering the human resource services described above.

The organization states that it was founded for and continues to support, encourage and promote cooperative activities among its members all over central State.

Based upon testimony during the initial interview:

The EO has a website, which the CEO updates and maintains, that hosts a wealth of information related to human resource issues, accessible by members when the login and provide their password.

The EO is experiencing a decline in membership dues. As such, the EO attempts to raise funds through conducting the activities described above. The CEO indicated his actions are consistent with the actions of his predecessor. The CEO said if the EO were revoked, he "would lose a lot of business" in the form of membership dues.

### **GOVERNMENT'S POSITION**

Audit work showed that program service revenue was incorrectly reported on page 8, Part VII. The book amounts of program services revenue were determined to be the best reflection of the EO's activities. Following is a comparison of tax vs. book analysis:

	<u>Book</u>	<u>Return</u>
Seminar Income	\$\$	\$\$
Consulting Income	\$ \$	\$\$
Referral fees	\$\$	
Training Services		\$ \$
Totals	\$\$	\$

In order to qualify for exemption as a business league under Reg. §1.501(c)(6)-1, an exempt organization must meet all of 6 tests:

- (1) Persons having a common business interest
- (2) Whose purpose is to promote the common business interest
- (3) Not organized for profit
- (4) That does not engage in a business ordinarily conducted for profit
- (5) Whose activities are directed at improvement of one or more lines of business as distinguished from the performance of particular services

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(6) Of the same general class as a chamber of commerce or a board of trade

1. The stated common business interest of taking an active role in development and education of the workforce and the manner in which the activities are conducted, are activities more aligned with a section 501(c)(3) organization, not a 501(c)(6) organization. The EO failed to show evidence of encouraging cooperation between government and business.

The promotion of the geographic region as a place to work is a stated common business interest. While this is an exempt activity of a C6, the EO failed to show evidence of this activity occurring.

The EO's stated common business interest of attempting to influence legislation germane to the common business interests of the EO's members can be an exempt purpose per Rev. Rul. 61-177 which provides that attempting to influence legislation germane to the common business interests of an organization's members is an exempt purpose under section 501(c)(6).

However, §1.162-20(c)(4), states attempting to influence legislation germane to the common business interests of an organization's members (i.e. Health Care Legislation, Free Choice Act, etc.) constitutes grass-roots lobbying, for which no business deduction (for example, the allocable portion of members' dues) is allowed. The EO provided no evidence to indicate this activity occurred.

Another of the EO's stated common business interest is directed at the promotion of higher business standards and better business methods. Rev. Rul. 81-175 defines the term "particular services" for the purposes of section 501(c)(6) of the Code, as acting in a manner which provides an economy or a convenience for members in the operation of their own businesses. Audit work showed that the EO's stated principal activities of improvement of working conditions and better business methods actually involved providing human resource services to members on request, which are not a common business interest, but rather providing a convenience to members in the operation of their own businesses and thus performing particular services for members.

The EO fails the first test.

2. The EO's stated purpose of promoting the common business interests of the members is realized through the members obtaining human resource services from the one-man operation of ORG, based upon requests from members on a member by member basis. This activity is not a promotion of an exempt common business interest, but rather is providing particular services to individuals (members).

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The EO's membership consists of a broad representation of businesses in . Audit work showed there was no common business interest shared by the members of the varied businesses. In Rev. Rul. 59-391, it states tax exemption has been denied for lack of a sufficient common business interest involving an organization of individuals engage in different trades or professions not in competition who exchanged business information. There is a strong interest in obtaining particular services from the EO in the form of human resource services. It appears the membership's prime interest is in the EO's CEO's expertise in human resource information, which involves providing particular services to individuals.

The EO fails the second test.

3. The EO's articles of incorporation and by-laws prohibit being organized for profit, as do section 501(c)(6) of the Code and section 1.501(c)(6)-1 of the regulations, but analysis of the EO's activities indicates the EO is organized for profit in it's primary activity as well as in non-primary activities. Those activities are delineated in 4. below.

The EO fails the third test of not being organized for profit.

4. The EO's primary activity is providing Human Resources (HR) services to members and is an activity ordinarily conducted for profit. These services are of the same character of services provided by HR consulting firms. The membership dues may be construed as being of the same character as that of a professional charging a retainer fee against which future services are applied. In Better Bus. Bureau v. United States, 326 U. S. 279. 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945) and Am. Campaign Acad. v. Commissioner, 92 T.C. 1056, 1065 (1989), it is stated that the presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number of exempt purposes. In Associated Master Barbers and Beauticians of America, Inc., 69 T.C. 53 (1977), the court held that an organization did not qualify as a tax-exempt business league because it both engaged in a regular business of a kind ordinarily carried on for profit and its activities were directed to the performance of particular services for individual members. The primary activity of providing HR services to members is an activity ordinarily carried on for profit and therefore is nonexempt. The EO's primary activity is one involving providing particular services to individual members in the form of human resources information specific to individual members. As a result, the subject EO's tax-exempt status is destroyed.

Less than a primary amount of a §501(c)(6) organization's activities may consist of furnishing particular services and/or engaging in unrelated trade or business, however if these activities are not primary activities, any income generated by them is unrelated business income. The EO engages in non-primary activities that are nonexempt activities.

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The EO's activity of offering employment services is a business ordinarily conducted for profit. American Association of Engineers Employment, Inc. v. Commissioner, 11 T.C.M. 207 (1952), aff'd 204 F.2d 19 (7<sup>th</sup> Cir. 1953) ruled that operating an employment agency precludes exemption of an organization under §501(c)(6). In Rev. Rul. 61-170 the position of the IRS is that the operation of an employment service by a tax-exempt association is an unrelated activity. Any income of the EO's activity is therefore taxable as unrelated business income under sec 513(a).

The EO's activity of promoting health insurance and long term disability plans and receiving referral fees is a business ordinarily conducted for profit. In Professional Insurance Agents of Michigan v. Commissioner, 726 F.2d 1097 (6<sup>th</sup> Cir. 1984), this court wrote that services which render benefits according to the fee that is paid for them are taxable business activities, not tax-exempt services. The fee generated here is the referral commission income to the subject EO from the insurance companies. The referral commission income is based upon the number of policies written by the insurance companies from the membership of the EO. Thus, the EO's service of referring business to the insurance companies and the resulting referral commission paid to the EO is a taxable business activity, not tax-exempt services.

In King County Insurance Association v. Commissioner, 37 B.T.A. 288 (1938) it was held that an association of insurance agents collecting (as an insubstantial activity) commissions on municipal insurance placed through its members is a business activity. The subject EO engages in collecting commissions/referral fees from insurance placed through its members and is by this definition a business activity. The EO's referral income from promotion of insurance products amounted to (as adjusted) \$\$ or % of the EO's total revenue, resulting in the insubstantial nonexempt activity of providing particular services to individuals.

In Louisiana Credit Union League v. U.S. 693 F.2d 525, the court observed that LCUL's insurance activities did little more than generate revenue for the League and provides CUNA/CUMIS with convenient services in the marketing and administration of its programs. Because the League's insurance endorsement is basically a fundraising activity, it is by definition unrelated business activity under section 513(a). Here, the EO did little more than generate revenue for the EO and certainly provides CO-2s and CO-3 Life with convenient services in the marketing of its programs. The EO's activities, in this case, are basically a fundraising activity, and by definition, an unrelated business activity under section 513(a) that also involves furnishing particular services to individual members.

In Carolinas Farm & Power Equipment Dealers Ass'n, Inc. v. U.S. 699 F.2d 167, C.A.N.C., 1983 January 24, 1983, we must conclude that the Association's insurance service primarily advances the interests of participating members, and so it is not related to its charitable purpose. The subject EO's activity advances the interests of



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participating members, and is thus providing particular services to individuals. Such an activity is not related to an organization's exempt purpose, and is taxable as unrelated taxable income under section 513(a).

The EO's activity of providing training seminars is, in this case, a business ordinarily conducted for profit and is certainly one which performs particular services for individuals. The CEO's words spell it out. "The training fulfills a need employers have to develop their employees or to upgrade their skills which they are unable to deliver themselves." Rev. Rul. 68-264 defines a particular service for the purposes of section 501(c)(6) of the Code as an activity that serves as a convenience or economy to the members of the organization in the operation of their own businesses.

In section 1.513-1.(d)(2) of the regulations it states where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. The activity's training seminar income is \$\$, only % of the EO's total revenue and as such does not contribute importantly to the accomplishment of the EO's exempt purpose. The activity is essentially a fundraising activity and by definition is an unrelated business activity under 513(a).

The EO's activity of HR consulting is a business ordinarily conducted for profit. Reg. §1.513-1.(b) defines an unrelated trade or business as of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities: The EO's primary activity of providing advice on human resources is a business ordinarily conducted for business, so the act of consulting the arena of human resources is also one of ordinarily conducted for profit. By virtue of the fact that the activity is basically a fundraising activity, it is by definition an unrelated business activity under 513(a). As such (as adjusted) \$\$ is unrelated business income. The EO is engaging in providing particular services to members when conducting this nonexempt activity.

Because the EO does engage in business activities, ordinarily conducted for business purposes, the EO fails the fourth test.

5. None of the EO's activities are directed at improvement of a line of business as distinguished from performing particular services. The EO's activities can be likened to the situation described in Rev. Rul. 59-391 where tax exemption has been denied for lack of a sufficient common business interest involving an organization of individuals engage in different trades or professions not in competition who exchanged business information. In this case, the EO is providing HR information, which is not directed at improvement of a line of business, but rather is providing particular services to persons.

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In MIB, Inc. v. Commissioner of Internal Revenue, 734 F.2d 71 (1st Cir. 1984), found that the "information exchange is developed around responding to individual member requests for data relevant to applicants seeking to buy insurance from that member." While business leagues "chiefly perform services for members collectively, MIB performs specific services for individual members." The subject EO responds to members' requests for human resource data and as such is performing specific services for individual members.

In Southern Hardwood Traffic Ass'n v. U.S. 283 F.Supp. 1013 D.C. Tenn. 1968. March 13, 1968, in the District Court, Bailey Brown, Chief Judge, held that unincorporated association engaged in regular business of providing, as one of its two main purposes and as substantial part of its total activity, majority of its members with individual services of kind ordinarily carried on for profit was not a 'business league' entitled to tax exempt status. The subject EO provides human resource services to its members utilizing 50 to 75% of its CEO's time. Providing human resource services is a substantial part of its total activity. Providing human resource services is of a kind ordinary carried on for profit. Providing human resource services to its members is performing particular services for individual persons. Therefore such an EO is not a business league entitled to tax exempt status.

Rev. Rul. 56-65 states that a local organization whose principle activity consists of furnishing particular information and specialized individual services to its individual members through publications and other means is performing particular services for individual persons. Such an EO is therefore not entitled to exemption under section 501(c)(6). The subject EO's principle activity consists of furnishing particular and specialized individual services to its individual members through response to individual requests for human resource information specific to the individual member; the EO is therefore performing particular services for individual persons.

Other activities of the EO are directed at providing particular services to persons.

The activity of promoting group health insurance and long term disability plans is providing particular services to individuals. Rev Rul. 74-81 states that by providing group workmen's compensation insurance for its members, the organization relieves the members of obtaining this insurance on an individual basis, resulting in a convenience in the conduct of their businesses. Therefore, the organization is rendering particular services for individual persons as distinguished from the improvement of business conditions in the contracting and related industries generally.

The subject EO's activity of providing employment services to individuals is also providing particular services to individuals. American Association of Engineers Employment, Inc. v. Commissioner ruled in processing applicants for engineering

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positions and charging fees for placements, petitioner was engaged in a regular business of a kind ordinarily carried on for profit and, therefore, is not a business league. The subject EO stated "occasionally, we are asked to help an employer with their search. When we find a qualified candidate we will request a small fee of usually 5% of base salary." Regardless of the frequency of service, this activity is one of providing particular services to individual persons.

The EO's brochure states, "We like for our member organizations to think of us as their other human resources department." The message of the EO's brochure is that the EO will provide high quality information and advice. Such language speaks to providing particular services to individuals. These particular services come in the form of answers to questions posed to the EO regarding human resources issues within member organizations. Rev. Rul. 81-175 defines the term "particular services" for the purposes of section 501(c)(6) of the Code, as acting in a manner which provides an economy or a convenience for members in the operation of their own businesses.

The EO's activity of providing training seminars involves performing particular services for individuals. The CEO says, "The training fulfills a need employers have to develop their employees or to upgrade their skills which they are unable to deliver themselves." Rev. Rul. 68-264 defines a particular service for the purposes of section 501(c)(6) of the Code as an activity that serves as a convenience or economy to the members of the organization in the operation of their own businesses. This activity is one of providing particular services to individuals as opposed to improvement of a line of business.

The EO fails the fifth test of activities which are directed at improvement of one or more lines of business as distinguished from the performance of particular services.

6. A chamber of commerce is defined by Webster's New International Dictionary to be 'A board or association to promote the commercial interests of a locality, a country, or the like.' In 11 C.J. 228, and Bouv. Law Dict. (Rawle's 3rd Rev.), it is defined as 'a society of a city, who meet to promote the general trade and commerce of the place.' This latter definition is quoted in Crooks v. Kansas City Hay Dealers' Ass'n (C.C.A.8) 37 F.(2d) 83, 85. In Rev Rul. 73-411, Trade associations or business leagues under section 501(c)(6) are similar to chambers of commerce, except that they serve only the common business interests of the members of a single line of business or of the members of closely related lines of business within a single industry. The subject EO has provided no evidence showing its activities serve a single line of business, or of the members of closely related lines of business within a single industry. The EO's activities are not of the same general class as that of a chamber of commerce.

Therefore the EO fails the sixth test.

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This organization fails all six tests under section 1.501(c)(6)-1 and as a result, is not entitled to remain exempt. The organization is engaged in the primary nonexempt activity of providing particular services to persons. The organization also engages in non-primary nonexempt activities involving activities normally conducted for business purposes and performing particular services for individuals.

### **CONCLUSION**

Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(6) and its tax exempt status should be revoked effective January 1, 20XX.

### **ALTERNATIVE ISSUE**

In the alternative, if the organization's exempt status under section 501(c)(6) is upheld, should the nonexempt activities' income be taxable as unrelated business income under section 511 of the Code?

### **FACTS**

ORG (ORG), a §501(c)(6) exempt organization was granted exemption on 07/22/19XX. The EO's exempt purpose as stated in Certificate of Incorporation is "for which the corporation is formed are to encourage and support the industries of the State, afford a medium of cooperation among the industries, work for constructive policies, oppose class legislation, to initiate, encourage, foster, and promote constructive activities on behalf of industry. ORG supports any industry, organization or business (public or private- service or manufacturing) with one or more employees."

The 20XX Form 990 states that the organization's primary purpose is to "support industries in \_\_\_\_\_".

The EO's brochure states "ORG's territory covers two-thirds of the geographical area within the state of State with a concentration of members in City, County, County, County, County, City, City, City, City, City and City. It represents approximately 100 businesses from all sectors of the economy in \_\_\_\_\_".

The EO's brochure states "Annual membership investment is based on average annual total number of employees, using the following formula:

- 1 – 50 employees \$
- 50 plus employees \$ per employee per year (\$\$ maximum)"

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Based upon a written response to an Information Document Request, the EO's program service activities consist of the following:

**Human Resources** - training, consultation, forms and procedures on wide variety of HR topics.

1. Service provider: CO-1
2. Service description: Help with understanding and compliance with labor & employment law practices, state & federal regulations and human resources best practices.
3. Frequency of service: Ongoing
4. Time spent/resources utilized: 50–75% of time goes to this. Email, telephone and website resources are utilized. Biggest resource is utilization of my time.
5. How provided: Through website, newsletter, email, seminars and meetings
6. Purpose served: Education of members and assistance to them in developing

**Insurance** – Health Insurance and Long Term Care Insurance Benefits

1. Service provider: CO-2s (Health Insurance) & CO-3 (Long Term Care)
2. Service description: CO-2's small group health plan is offered to members with 1-99 employees. Members who enroll get free vision care and free Employee Assistance Plan benefits. CO-3's Long Term Care insurance product is offered to ORG members at a discounted rate.
3. Frequency of service: These services are offered on an ongoing basis to ORG members.
4. Time spent/resources utilized: Most of ORG's efforts involve awareness and promotion through the newsletter, emails and website.
5. How provided: Services are provided by a third party.
6. Purpose served: *(None Provided)*

**Seminars** – such as Software Training and seminars on HR and managerial topics

1. Service provider: ORG, Community College and an occasional outside instructor.
2. Service description: Training is offered on in Microsoft Office Suite (Word, Excel, PowerPoint and Access – Versions 20XX and
3. Frequency of service: 20XX). Training is also offered on a variety of topics relating to management & supervisory skills, labor & employment law and state & federal regulation compliance issues.
4. Time spent/resources utilized: There are approximately 20 seminars per year. Half are human Resources related, the other half related to software training.
5. How provided: Most of the Human Resources seminars are provided at ORG's Office conference room. All of the software training classes are conducted in the Central State Community College's Computer Lab.
6. Purpose served: The training fulfills a need employers have to develop their employees or to upgrade their skills which they are unable to deliver themselves.

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Information from the EO's 20XX Form 990:

On page 1, Part 1, line 12, the EO's Total revenue is \$.

On page 1, Part 1, line 2, Program service revenue is \$. Included in program service revenue (as adjusted) are the following:

Seminar Income	\$ \$
Consulting Income	\$ \$
Referral fees	\$ \$

On page 1, Part 1, line 3, Membership dues are \$ \$.

On page 1, Part 1, line 4, Interest on savings and temporary cash investments is \$.

On page 1, Part 1, line 9c, Net income from fundraising activities (sponsoring a golf tournament) is \$ \$.

On page 8, Part VII, the exclusion code of "3" was used to exclude program service revenue from unrelated business income

The organization did not file a Form 990-T, Exempt Organization Business Income Tax Return, for the year under examination.

**LAW**

Section 511(a) of the Code imposes a tax upon the unrelated business taxable income of organizations exempt from federal income tax, including organizations described in section 501(c)(6) of the Code.

Section 512(a) of the Code defines unrelated business taxable income as gross income from any unrelated trade or business.

Section 513(a) of the Code defines the term unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income of funds or the use it makes of the profits derived) to the exercise of performance by such organization of its exempt functions.

Section 513(c) of the Code provides that a trade or business includes any activity which is carried on for the production of income from the sale of goods or performance of services. An activity does not lose its identity a trade or business because it is carried

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on within a larger aggregate of similar activities or within a larger complex of other endeavors which may not be related to the exempt purposes of the organization.

Section 1.513-1(b) of the regulations provides that the term "trade or business" for purposes of section 513 of the Code has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or services.

In Rev Rul. 66-151 it states even where a principal purpose is not the operation of a business, an association may nonetheless be subject to liability for the unrelated business income tax, notwithstanding the fact that the business is conducted with its members.

In Rev. Rul. 67-182 it states that a business league was denied exemption for maintaining a library for its members' use.

Rev. Rul. 68-264 defines a particular service for the purposes of section 501(c)(6) of the Code as an activity that serves as a convenience or economy to the members of the organization in the operation of their own businesses.

Rev Rul. 73-411 Trade associations or business leagues under section 501(c)(6) are similar to chambers of commerce, except that they serve only the common business interests of the members of a single line of business or of the members of closely related lines of business within a single industry.

In Rev Rul. 74-81, it states that by providing group workmen's compensation insurance for its members, the organization relieves the members of obtaining this insurance on an individual basis, resulting in a convenience in the conduct of their businesses. Therefore, the organization is rendering particular services for individual persons as distinguished from the improvement of business conditions in the contracting and related industries generally.

In Associated Master Barbers and Beauticians of America, Inc., 69 T.C. 53 (1977), the court held that an organization did not qualify as a tax-exempt business league because it both engaged in a regular business of a kind ordinarily carried on for profit and its activities were directed to the performance of particular services for individual members.

In Carolinas Farm & Power Equipment Dealers Ass'n, Inc. v. U.S. 699 F.2d 167, C.A.N.C., 1983. January 24, 1983, we must conclude that the Association's insurance service primarily advances the interests of participating members, and so it is not related to its charitable purpose.

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The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number of exempt purposes. Better Bus. Bureau v. United States, 326 U. S. 279, 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v. Commissioner, 92 T.C. 1056, 1065 (1989).

In Professional Insurance Agents of Michigan v. Commissioner, 726 F.2d 1097 (6<sup>th</sup> Cir. 1984), this court wrote that services which render benefits according to the fee that is paid for them are taxable business activities, not tax-exempt services.

In King County Insurance Association v. Commissioner, 37 B.T.A. 288 (1938) it was held that an association of insurance agents collecting (as an insubstantial activity) commissions on municipal insurance placed through its members is a business activity. The subject EO engages in collecting commissions/referral fees from insurance placed through its members and is by this definition a business activity.

In Louisiana Credit Union League v. U.S. 693 F.2d 525, the court observed that LCUL's insurance activities did little more than generate revenue for the League and provides CUNA/CUMIS with convenient services in the marketing and administration of its programs. Because the League's insurance endorsement is basically a fundraising activity, it is by definition unrelated business activity under section 513(a). Here, the EO did little more than generate revenue for the EO and certainly provides CO-2s and CO-3 Life with convenient services in the marketing of its programs.

### TAXPAYER'S POSITION

The organization believes their activities are exempt from Federal tax in that they are used in performing its exempt purpose.

### GOVERNMENT'S POSITION

Audit work showed that program service revenue was incorrectly reported on page 8, Part VII. The book amounts of program services revenue were determined to be the best reflection of the EO's activities. Following is a comparison of tax vs. book analysis:

	<u>Book</u>	<u>Return</u>
Seminar Income	\$ \$ \$ \$	
Consulting Income	\$ \$ \$ \$	
Referral fees	\$ \$	
Training Services		\$ \$
Totals	\$ \$ \$	



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The EO's primary activity is providing Human Resources (HR) services to members, utilizing to % of the CEO's time, and is an activity ordinarily conducted for profit. These services are of the same character of services provided by HR consulting firms. The membership dues may be construed as being of the same character as that of a professional charging a retainer fee against which future services are applied. In Better Bus. Bureau v. United States, 326 U. S. 279, 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945) and Am. Campaign Acad. v. Commissioner, 92 T.C. 1056, 1065 (1989), it is stated that the presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number of exempt purposes. In Associated Master Barbers and Beauticians of America, Inc., 69 T.C. 53 (1977), the court held that an organization did not qualify as a tax-exempt business league because it both engaged in a regular business of a kind ordinarily carried on for profit and its activities were directed to the performance of particular services for individual members. The primary activity of providing HR services to members is an activity ordinarily carried on for profit and therefore is nonexempt. The EO's primary activity is one involving providing particular services to individual members in that the EO responds to specific requests for information pertinent to the individual member's business. As a result, the subject EO's tax-exempt status is destroyed.

In this case, the subject EO's primary activity is not an exempt activity. Therefore the associated income is unrelated business income, taxable under section 513(a).

As shown above, the principal business activity of providing particular services to persons, in the form of providing HR information to members on request, is not an exempt activity. As such, membership dues become nonexempt income in proportion to the percentage of the EO's resources spent in performing the nonexempt activities. Both the principal business activity and the allocable portion of membership dues are subject to taxation under section 511(a) of the Code.

The CEO stated that to % of his time is spent on the primary nonexempt activity. Utilizing the CEO's statement of time spent on this primary nonexempt activity, %, or \$\$ of membership dues are allocated to and are taxable as unrelated business income under sec 513(a).

The organization's program services revenue addressed below have no causal relationship to the stated exempt purpose based upon the foregoing conclusion. Thus, it does not contribute importantly to the accomplishment of the organization's exempt purpose.

Form 990, page 8, Part VII incorrectly excluded program service revenue from taxation as unrelated business income, utilizing an exclusion reserved for §501(c)(3) organizations.

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Seminars conducted/sponsored by the EO are not a primary activity of the EO but produce income for the EO of \$\$\$. The EO states that "The training fulfills a need employers have to develop their employees or to upgrade their skills which they are unable to deliver themselves." According to Rev. Rul. 68-264, it defines a particular service for the purposes of section 501(c)(6) of the Code as an activity that serves as a convenience or economy to the members of the organization in the operation of their own businesses. Thus by definition, income from seminars conducted/sponsored are particular services in that they provide both a convenience to the employer and an economy to the members in the operation of their own businesses. While less than a primary amount of a §501(c)(6) organization's activities may consist of furnishing particular services and/or engaging in unrelated trade or business, if these activities are not primary activities, any income generated by them is unrelated business income. In this case, the income of \$\$\$ is taxable as unrelated business income under Section 513(a) of the Code.

Consulting income generated by the EO is not a primary activity of the EO, but produced \$\$\$ of income for the EO. Section 513(c) of the Code provides that a trade or business includes any activity which is carried on for the production of income from the sale of goods or performance of services. Reg. §1.513-1.(b) defines an unrelated trade or business as of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities. The EO's primary activity of providing advice on human resources is a business ordinarily conducted for business, so the act of consulting the arena of human resources is also one of ordinarily conducted for profit. By virtue of the fact that the activity is basically a fundraising activity, it is by definition an unrelated business activity under 513(a). The EO is engaging in providing particular services to members when conducting this nonexempt activity. While less than a primary amount of a §501(c)(6) organization's activities may consist of furnishing particular services and/or engaging in unrelated trade or business, if these activities are not primary activities, any income generated by them is unrelated business income. In this case, the income of \$\$\$ is taxable as unrelated business income under Section 513(a) of the Code.

Referral fees (or commissions) from members purchasing health insurance products from CO-2s and long term care products from CO-3 Life are not the result of a primary activity of the EO, but produced \$\$\$ of income for the EO. In Carolinas Farm & Power Equipment Dealers Ass'n, Inc. v. U.S. 699 F.2d 167, C.A.N.C., 1983. January 24, 1983, we must conclude that the Association's insurance service primarily advances the interests of participating members, and so it is not related to its charitable purpose. If an activity is not related to its exempt purpose, it is an unrelated business activity. Rev Rul. 74-81 states that by providing group workmen's compensation insurance for its members, the organization relieves the members of obtaining this insurance on an individual basis, resulting in a convenience in the conduct of their businesses.

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Therefore, the organization is rendering particular services for individual persons as distinguished from the improvement of business conditions in the contracting and related industries generally. In King County Insurance Association v. Commissioner, 37 B.T.A. 288 (1938) it was held that an association of insurance agents collecting (as an insubstantial activity) commissions on municipal insurance placed through its members is a business activity. The subject EO engages in collecting commissions/referral fees from insurance placed through its members and is by this definition a business activity. The EO's referral income from promotion of insurance products amounted to \$\$ or

% of the EO's total revenue, resulting in the insubstantial nonexempt activity of providing particular services to individuals. In Louisiana Credit Union League v. U.S. 693 F.2d 525, the court observed that LCUL's insurance activities did little more than generate revenue for the League and provides CUNA/CUMIS with convenient services in the marketing and administration of its programs. Because the League's insurance endorsement is basically a fundraising activity, it is by definition unrelated business activity under section 513(a). Here, the EO did little more than generate revenue for the EO and certainly provides CO-2s and CO-3 Life with convenient services in the marketing of its programs. The EO's activities, in this case, are basically a fundraising activity, and by definition, an unrelated business activity under section 513(a) that also involves furnishing particular services to individual members. While less than a primary amount of a §501(c)(6) organization's activities may consist of furnishing particular services and/or engaging in unrelated trade or business, if these activities are not primary activities, any income generated by them is unrelated business income. In this case, the income of \$\$ is taxable as unrelated business income under Section 513(a) of the Code.

#### Summary of Unrelated Business Income

Primary Activity – HR Services (Allocated % of Membership Dues)	\$ \$
Seminar Income	\$ \$
Referral Commissions (Insurance Products)	\$ \$
HR Consulting	\$ \$
<b>Total Unrelated Business Income</b>	<b>\$ \$</b>

#### CONCLUSION

The organization's program service revenue and allocable portion of its membership dues are taxable as unrelated business income. The organization shall prepare and file Form 990-T for the tax year ending in 20XX, reporting all unrelated business income.